United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 14868

BESSIE LASKY and JESSE L. LASKY, *Petitioners,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

Petitions to Review Decisions of The Tax Court of the United States

PETITIONERS' BRIEF

ROBERT ASH,
CARL F. BAUERSFELD
1921 Eye Street, N. W.
Washington, D. C.
Attorneys for Petitioners

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

TABLE OF CONTENTS

TABLE OF CASES CITED

OTHER AUTHORITY

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 14868

BESSIE LASKY and JESSE L. LASKY, *Petitioners,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

Petitions to Review Decisions of The Tax Court of the United States

PETITIONERS' BRIEF

JURISDICTIONAL STATEMENT

Jurisdiction of the Tax Court

Petitioners on review filed Federal Income Tax Returns for the taxable year 1943 with the collector of Internal Revenue for the Sixth District of California at Los Angeles, California, which is within the jurisdiction of this Court. (R. 19) On November 28, 1949, the Commissioner of Internal Revenue sent to petitioners, by registered mail, notices of deficiencies, in which he determined that the peti-

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 14868

BESSIE LASKY and JESSE L. LASKY, *Petitioners,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

Petitions to Review Decisions of The Tax Court of the United States

---

PETITIONERS' BRIEF

JURISDICTIONAL STATEMENT

Jurisdiction of the Tax Court

Petitioners on review filed Federal Income Tax Returns for the taxable year 1943 with the collector of Internal Revenue for the Sixth District of California at Los Angeles, California, which is within the jurisdiction of this Court. (R. 19) On November 28, 1949, the Commissioner of Internal Revenue sent to petitioners, by registered mail, notices of deficiencies, in which he determined that the peti-

tioner, Bessie Lasky, owed a deficiency in income tax for the taxable year 1943 in the amount of $224,722.55; and that the petitioner, Jesse L. Lasky, owed a deficiency in income tax for the taxable year 1943 in the amount of $224,515.14. (R. 10-14, 62) Thereafter, on January 9, 1950, petitioners duly filed appeals from said determination with the Tax Court of the United States. (R. 7-14) The case was tried before the Tax Court on April 8, 1954. The Tax Court promulgated its findings of fact and opinion (R. 62-92) and entered its decision ordering and deciding that the taxpayers owe the deficiencies in income tax for the taxable year 1943 in the amount as determined by the Commissioner of Internal Revenue. (R. 92-93)

Thereafter, on August 24, 1954, petitioners filed a motion for leave to file a motion to vacate the decisions out of time and a motion to vacate decisions entered April 8, 1954. (R. 93-94) On December 13, 1954, the Tax Court entered an order vacating and setting aside the decisions of April 8, 1954, and granted the petitioners a further hearing on the merits. (R. 135) Thereafter, a re-hearing of the case was held in Washington, D. C., on January 21 and January 26, 1955. (R. 300, 355) On June 30, 1955, the Tax Court in the case of each petitioner entered a memorandum sur order and decision, again ordering and deciding upon the re-hearing and reconsideration of the case on the merits that there are deficiencies in income tax for the taxable year 1943 as determined by the Commissioner of Internal Revenue. (R. 138-145)

Jurisdiction of Court of Appeals

Petitions for review were filed on August 10, 1955, to review the orders and decisions entered by the Tax Court on June 30, 1955. (R. 149) Jurisdiction is conferred upon this Court by Sections 1141 and 1142 of the Internal Revenue Code of 1939 and Sections 7482 and 7483 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

On March 23, 1940, Jesse L. Lasky acquired from Sgt. Alvin C. York the exclusive motion picture, radio, television and dramatic rights to the life story of York. Thereafter, on May 15, 1940, Lasky conveyed all his rights, title and interest under the contract of March 23, 1940 with York to Warner Bros. In consideration for all his rights, title and interest under the contract of March 23, 1940, Warner Bros. agreed to pay Lasky $40,000 plus a certain percentage of the gross film rentals or sales realized from the distribution of the photoplay. In addition, by a separate and distinct contract, Warner Bros. employed Lasky as a co-producer for the purpose of producing the play based upon the life of Sgt. York. After the picture "Sergeant York" was released, a dispute and dissatisfaction existed between Lasky and Warner Bros. Lasky was dissatisfied with the way Warner Bros. was distributing the picture. He was also dissatisfied with the receipts that were tendered him from the distribution of the picture. After consulting his attorney, certain checks tendered to Lasky by Warner Bros. as his share of the film rentals were returned to Warner Bros. At that time it was contemplated that an accounting of the distribution by Warner Bros. would be demanded by Lasky. However, Lasky wished to avoid a dispute with Warner Bros. because he was then in their employ as a producer, and he decided to sell his rights under the contract of May 15, 1940, with Warner Bros. Accordingly, on December 4, 1942, he sold his rights under the contract of May 15, 1940, to United Artists Corporation for $805,000. Petitioners reported the gain from the sale as gain from the sale of a capital asset. The Commissioner of Internal Revenue determined, and the Tax Court held, that the gain resulting from the sale was taxable as ordinary income.

The question for decision is: Was the gain from the sale of petitioner's contractual rights with Warner Bros. to United Artists Corporation on December 4, 1942, taxable as ordinary income or as capital gain from the sale of a capital asset?

STATUTE INVOLVED

Internal Revenue Code (1939) as amended:

"Sec. 117. *Capital Gains and Losses.*

"(a) *Definitions.*—As used in this chapter—

"(1) *Capital assets.*—The term 'capital assets' mea
property held by the taxpayer (whether or not co
nected with his trade or business), but does not inclu
stock in trade of the taxpayer or other property of
kind which would properly be included in the inventor
of the taxpayer if on hand at the close of the taxab
year, or property held by the taxpayer primarily f
sale to customers in the ordinary course of his trad
or business, or property, used in the trade or busines
of a character which is subject to the allowance for d
preciation provided in section 23 (1), or an obligatio
of the United States or any of its possessions, or of
State or Territory, or any political subdivision thereo
or of the District of Columbia, issued on or after Marc
1, 1941, on a discount basis and payable without inte
est at a fixed maturity date not exceeding one yea
from the date of issue, or real property used in th
trade or business of the taxpayer.

"(2) *Short-term capital gain.*—The term 'short-ter
capital gain' means gain from the sale or exchange
a capital asset held for not more than 6 months, if an
to the extent such gain is taken into account in com
puting net income;

* * *

"(4) *Long-term capital gain.*—The term 'long-term cap
ital gain' means gain from the sale or exchange of
capital asset held for more than 6 months, if and to th
extent such gain is taken into account in computing ne
income;"

STATEMENT OF THE CASE

Petitioners are husband and wife. They resided in Los Angeles, California during 1942 and 1943. Each filed separate income tax returns on the cash basis with the Collector for the Sixth District of California. Their income in 1942 [1] and 1943 was community income. For the purposes of this statement, Jesse L. Lasky will be referred to hereinafter as the petitoner.

The petitioner's occupation has been that of motion picture producer since 1913, and he has produced many pictures. Prior to March 1940, petitioner as an individual had not purchased any literary property, but as Vice President in charge of Production of Paramount, many literary properties passed through his hands. In the early part of 1940, petitioner negotated with Alvin York, a hero of World War I, for the purchase of the exclusive motion picture, radio, television and dramatic rights to the life story of York. On March 23, 1940, petitioner and York entered into an agreement which provided *inter alia* as follows: (Ex. 1-A, R. 25-26)

> "II. York further gives, grants, bargains, sells, assigns and sets over unto Lasky, his heirs, executors adminstrators, and assigns, the sole and exclusive right to use the name and likeness of York in connection with one or more story or stories, films or photoplays for motion picture, television and/or radio presentation and/or exhibitions based upon or using or containing one or more incidents in, of or from the life of York, including the right to dramatize, exhibit and/or present any incident occurring or which did occur in the life of York by every visual and/or audible means whether now known or hereafter invented or discovered. Such transmission or presentation may be through the use or by means of living actors in the actual and immediate presence of an audience or by any other and different

[1] The year 1942 is involved because of the provisions of The Current Tax Payment Act of 1943.

means, medium or device of whatsoever nature c description.

The name 'Alvin C. York' or any part, thereof, whethe alone or in connection or in conjunction with any othe word or phrase may, but need not be used in the tit or sub-title of any motion picture, play, story, nov or serial or radio or television presentation, fiction or otherwise, containing any one or more incidents i of or from the life of York, and the advertising and/c publicity relating to any motion picture, play, stor novel, serial or radio or television presentation writte made or produced pursuant to this agreement, whethe fictional or otherwise, may include the statement tha it is based upon, taken from or is the story of the li of Alvin C. York, or some similar statement."

In consideration for the rights received, petitioner pai York $25,000 upon the execution of the agreement of Marc 23, 1940 and agreed to pay an additional $25,000 at th expiration of either 18 months from the date of the execu tion of the agreement, or upon the date following the releas of any motion picture made pursuant to the agreemen whichever was earlier. Failure to pay the second $25,00 would result in termination of the agreement. In additio Lasky agreed to pay York a sum equal to 4 percent of th gross receipts from the distribution of each motion pictur in excess of $3,000,000; 5 percent in excess of $4,000,000 6 percent in excess of $6,000,000; and 8 percent in exces of $9,000,000. It was provided that if the contract shoul be assigned to a production or distribution corporation, th assignee would assume all of Lasky's obligations. (R. 64

Petitioner flew to Hollywood, California, where he ar rived on or about March 25, 1940. He shopped around t sell the story for the production of a motion picture base upon the life story of Sgt. York. He discussed the stor with Sam Goldwyn and with Paramount, but they were no interested in producing the picture. At this time he wa very much concerned about selling the picture because h

had paid $25,000 for the rights under the contract of March 23, 1940, with York, and he would owe $25,000 more within 18 months, or lose the first $25,000 which he had paid to York. Accordingly, he was anxious to sell the story to a producing company. (R. 64-65, 342-343). He then called on Harry and Jack Warner of Warner Bros., Inc., and they agreed to purchase Lasky's rights under the contract of March 23, 1940, with York. In addition they agreed to employ Lasky as the supervising producer of a picture based upon the life of Sgt. York. (R. 65)

Petitioner first went to Warner Bros. for the purpose of selling them all of his rights, title, and interest to and under the agreement of March 23, 1940, which he had acquired from Sgt. York. He reached an oral understanding with Warner Bros. regarding the purchase of his rights under the agreement of March 23, 1940, with York. After Warner Bros. had agreed to purchase his rights under the agreement of March 23, 1940, with York, he reached an oral agreement with Warner Bros. whereby he was employed as a supervising producer. Thereafter, written instruments were prepared and executed embodying the terms of the oral agreements. One agreement is dated May 8, 1940, by which Warner Bros. employed Lasky as the supervising producer of a photoplay tentatively entitled "The Amazing Story of Sergeant York." Another agreement is dated May 15, 1940, by which Lasky sold to Warner Bros. all of his rights to the York story and all other rights he had acquired under the York contract of March 23, 1940. A third agreement was simultaneously executed entitled "Supplemental Agreement" which also was dated May 15, 1940, by which Warner Bros. agreed to pay Lasky a part of the gross receipts in varying percentages from the distribution of the photoplay "The Amazing Story of Sergeant York." (R. 65, 161-164, 176-177, 200-201, 218, 341-343)

In general the agreement of May 8, 1940 provided that Lasky would render services as a supervising producer of

the York photoplay and such other photoplays as might be selected by mutual consent for a period of 52 weeks from April 1, 1940, and that Lasky would receive for all of his services under the contract at least $60,000, payable at the rate of $1,500 per week (R. 66-67). Under the agreements of May 15, 1940, Warner Bros. in general agreed to pay Lasky $40,000 for all of his rights, title, and interest in the York agreement of March 23, 1940, plus a part of the gross receipts from domestic and foreign distribution during not more than five years after the date of release of the York photoplays. Warner Bros. assumed all of Lasky's obligations under the York contract. (R. 67)

Under the "Supplemental Agreement" of May 15, 1940 which was a participation agreement, Warner Bros. agreed to pay Lasky 20 percent of the gross film rentals realized from the motion picture in excess of $1,600,000 from domestic proceeds and a similar percentage of the foreign proceeds in excess of $150,000 and when domestic and foreign proceeds reached $2,500,000 Warner Bros. would pay Lasky a sum equal to 25 percent of the excess above such figure instead of 20 percent (R. 68-69).

A photoplay entitled "Sergeant York" was produced. It was released in the United States and Canada in July 1941 (R. 69). After the picture "Sergeant York" was released petitioner was informed that Warner Bros. was not making a proper distribution of the picture. It was believed that Warner Bros. was renting the picture to theatres it owned and controlled at lower rentals than they rented it to independent theatres. In addition, it was felt "Sergeant York," a successful picture, was being used to sell less desirable pictures which were wholly owned by Warner Bros. This affected the percentage of the gross receipts due petitioner (R. 169-170, 241-242, 274-275, 277-279, 314-315, 345-347).

In November 1941, petitioner received a letter from Albert Warner dated November 24, 1941, pointing out that the cost of producing the picture "Sergeant York" was

more than had been anticipated. In the letter Warner Bros. requested petitioner to agree that he would not participate in a percentage of the gross rentals until the gross rentals exceeded $2,200,000 instead of $1,600,000 as provided in the supplemental contract. (R. 169-170, 255, 275, 313-314 346-348, Ex. 9 R. 444-445)

Petitioner consulted his attorney about the letter received from Warner Bros. dated November 24, 1941. His attorney advised that he was not required to change the terms of the supplemental contract with Warner Bros. and recommended that he not accede to the request contained in the letter of November 24, 1941. Accordingly, petitioner wrote a letter to Albert Warner on December 4, 1941, refusing to agree to the request that he not participate in the percentage of the gross rentals until the gross rentals exceeded $2,200,000 instead of $1,600,000 as provided in the supplemental contract. The letter contained in detail the reasons for petitioner's refusal. (R. 169-170, 313-314, 346-348, Ex. 10, R. 446-454)

Up until the time the petitioner refused to accede to the request contained in the letter from Warner Bros. dated November 24, 1941, very pleasant relationships existed between petitioner and his employer, Warner Bros. After the refusal to comply with the request contained in the letter of November 24, 1941, the relationship between petitioner and his employer, Warner Bros., became strained. (R. 255, 346)

Warner Bros. followed the practice of mailing statements to Lasky which were designated "Statement to Jesse L. Lasky covering distribution of production 'Sergeant York' to (date)," together with a check for the amount of Lasky's participating share as shown by the statement (R. 70).

When petitioner received his first statement which was mailed with a letter dated December 15, 1941, the statement showed gross income from distribution of the picture "Ser-

geant York" within the United States of $1,706,084.02 With this statement, petitioner received a check for $21, 216.80. Petitioner was disturbed upon the receipt of thi statement because the *New York Times* quoted gross rental to be $4,000,000 and trade magazines, *Variety* and *Reporter* were also quoting substantially higher figures than wer shown on the statement received from Warner Bros. Ac cordingly, petitioner consulted his attorney and an account ant about the situation. (R. 70, 76, 169-170, 279-280, 311 314, 326-327, 345-346; Ex. O, R. 417-418)

Upon the receipt of the first statement from Warne Bros., petitioner's attorney and accountant both advise him to have an audit made of the distribution of the produc tion "Sergeant York" but to wait until there was as broa a distribution as possible before having the audit made Petitioner at that time agreed to have an audit. R. 271-27 278-279, 285, 314-317, 329, 351-352)

After the receipt of the first statement from Warne Bros., petitioner's attorney advised him not to accept th checks which accompanied the statements covering the dis tribution of "Sergeant York" to February 28, 1942. Th same advice was given with respect to all subsequent state ments. Petitioner's attorney was of the opinion tha the legend on the vouchers would preclude petitione from demanding an adjustment in the account if it wa found he was entitled to additional moneys from Warne Bros. Petitioner's attorney returned three checks receive from Warner Bros. in 1942 totaling $570,698.62. (R. 77-78 241-242, 278, 315-316, 351-352)

Petitioner was requested by Warner Bros. to pay part o the cost of an advertising compaign to promote the pictur "Sergeant York". Under the contracts between petitione and Warner Bros., petitioner was not required to shar in the advertising cost. Petitioner consulted his attorney and was advised that he was not required and should no agree to share in the advertising cost. Despite this advice

petitioner, in an effort to placate Warner Bros. and to regain the friendly relationship between himself and his employer, did agree to and did pay a part of the advertising cost in the amount of $18,998.00. (R. 75, 170, 255, 316, 348; Ex. 6, R. 55-56; Ex. P, R. 418-420)

Warner Bros. was threatened with a plagiarism suit by the heirs of an author who had written a book based on the life of Sergeant York. As a result of the claim made by the Skeyhill heirs, Warner Bros. withheld $10,000 from the amount properly due petitioner in their statement covering distribution of the production "Sergeant York" to February 28, 1942. Petitioner had not agreed to the withholding of any amount upon the claim of the Skeyhill heirs and was not required under his contracts with Warner Bros. to pay any part of the alleged claim. Accordingly, petitioner consulted his attorney and accountant about Warner Bros. withholding the $10,000 on account of the alleged claim of the Skeyhill heirs. (R. 76, 270-271, 279-280, 349)

On about May 6, 1942, Lasky instructed Warner Bros. to send future statements of account and participation checks, and other matters directly to his attorney. (R. 76) The statement of Warner Bros. covering distribution of the production "Sergeant York" to February 28, 1942, showed foreign income from distribution. Petitioner discussed the income from foreign distribution with his attorney and accountant who raised a question about the propriety of Warner Bros. classifying earnings in England as restricted funds. Question was also raised about a deduction for quota losses in England. Question was also raised as to the possibility that Warner Bros. might be using the blocked funds in England for their own expenditures. Warner Bros. proposed to withhold $200,000 of foreign receipts due petitioner. Mr. Wright, petitioner's attorney, discussed the proposal with officials of Warner Bros. and pointed out that Warner Bros. was not entitled to withhold the foreign funds from petitioner. (R. 76-77, 80, 169, 241-242, 255-256, 274, 280-281, 316-319)

Although petitioner's attorney and accountant advise
him to have an audit made of the distribution of the pr
duction "Sergeant York", petitioner was reluctant to do
because he felt that an audit would show discrepancies a
that he was entitled to additional moneys. If the aud
showed discrepancies, his position as an employee
Warner Bros. would become untenable. Petitioner ha
been working for different studios and wanted to contin
in the employ of Warner Bros. for the remainder of h
life. He did not want a controversy at this time wi
Warner Bros., and, therefore, he acquiesced in Warn
Bros. retaining the $10,000 to pay the possible plagiaris
claim. (R. 256, 274, 349-350)

Warner Bros. was aware that petitioner was dissati
fied with the distribution and his receipts from the distrib
tion of the picture "Sergeant York". R. 281, 303-304, 30
359-362)

The reason petitioner sold his rights under the contra
of May 15, 1940, and the supplemental contract of May 1
1940, between petitioner and Warner Bros., to United A
tists Corporation, on December 4, 1942, was to avoid a
additional unpleasantness or controversy and in order
be able to continue in the employ of Warner Bros. as
producer for the balance of his natural life. Petitione
felt that if he disposed of his rights under the contrac
of May 15, 1940, he would be able to continue in the empl
of Warner Bros. without any further trouble or disput
Therefore, instead of having an audit investigation, pe
tioner decided to sell his rights under the contracts. (
78, 169-170, 254-256, 258, 274-275, 349-350)

Petitioner did not personally handle any of the negoti
tions leading to the sale of his rights under the contrac
of May 15, 1940, to United Artists on December 4, 194
Loyd Wright, petitioner's attorney, handled the negoti
tions. Mr. Wright communicated with Mr. Adolph Zuk

and United Artists Corporation in an effort to sell petitioner's rights under the contracts of May 15, 1940. Mr. Zukor, in conjunction with some other persons, offered to purchase Mr. Lasky's rights under the contracts of May 15, 1940, for $800,000. Later, Mr. Wright was able to sell the rights to United Artists Corporation for $805,000. Petitioner was advised that this was a fair offer and agreed to sell. (R. 80, 254-256, 281-282, 286-287, 322-323 330, 350-351, 353)

Under the contract of December 4, 1942, petitioner sold to United Artists all his interest in the original and supplemental agreements with Warner Bros. dated May 15, 1940, and all his interest in the motion picture "Sergeant York", including the proceeds thereof, rights of accounting thereof, money due or to become due thereof, from Warner Bros. Pictures, Inc. (R. 81, Ex. 7-B, R. 56)

Prior to selling the rights under the contracts of May 15, 1940, to United Artists Corporation, petitioner had no knowledge or understanding that United Artists Corporation intended to resell the rights to Warner Bros. (R. 324, 351, 360-361)

The sale of petitioner's rights under the contracts of May 15, 1940, to United Artists was negotiated between Mr. Wright, attorney for petitioner, and Mr. Edward C. Raftery, President and chief counsel of United Artists. During the negotiations, Mr. Raftery consulted with Mr. Gradwell Sears, the General Sales Manager of United Artists, who had previously been employed by Warner Bros. as General Sales Manager at the time the picture "Sergeant York" was released. Mr. Raftery was only interested in buying Lasky's rights if United Artists Corporation could make some money by acquiring the rights. Sears advised Raftery that the picture had a great potential and to buy petitioner's rights. He made the recommendation to buy because he thought United Artists Corporation could make

money out of the transaction. (R. 141-142, 284, 286-28
302-304, 357-360, 373-374)

Sears, the General Sales Manager, wanted United Artis
Corporation to hold the rights it acquired from petitione
and not resell them. Sears advised Raftery that the pi
ture was an enormous success and if it held the righ
United Artists Corporation would receive over a millio
dollars itself. However, Mr. Raftery wanted to resell th
Lasky interest for two reasons: (1) because United Artis
Corporation did not have the right to distribute the pi
ture, and (2) in order to make a quick profit. Therefor
United Artists Corporation sold the rights to Warne
Bros. on December 22, 1942. (R. 303-304, 324, 357-36
364-365, 371, 373-374)

Warner Bros. purchased the rights United Artists Co
poration had acquired from petitioner under contract date
December 22, 1942, for $820,000. It insisted that the selle
United Artists Corporation, on behalf of Jesse L. Lask
fully release Warner Bros. from any claims that Lask
might have in and to the receipts from the distributio
and exhibition of the picture "Sergeant York". (R. 36
362, Ex. AA, R. 439)

Petitioners reported in their return for 1942, one-ha
of the payment of $805,000 as long term capital gain fro
the sale of a capital asset. The Commissioner of Intern
Revenue rejected this treatment of the receipt of $805,00
and taxed the entire amount as ordinary income. The ta
Court sustained the Commissioner. (R. 84-85)

SPECIFICATION OF ERRORS

The Tax Court of the United States erred:

1. In holding and deciding that the proceeds from th
sale by petitioner Jesse L. Lasky of his rights under co
tracts of May 15, 1940, with Warner Bros., to United Artis
Corporation, for $805,000, were taxable as ordinary incom
instead of at capital gains rates.

2. In failing to hold that the proceeds from the sale by petitioner Jesse L. Lasky of his rights under contracts of May 15, 1940, with Warner Bros., to United Artists Corporation were taxable as the sale of a capital asset.

3. In failing to hold that the agreement of May 15, 1940, and the supplemental agreement of May 15, 1940, by which petitioner Jesse L. Lasky sold to Warner Bros. all his rights to the "Sergeant York" story and Warner Bros. agreed to pay petitioner a part of the gross receipts in varying percentages from the distribution of the photoplay, are entirely separate and distinct from the employment contract between petitioner Jesse L. Lasky and Warner Bros. dated May 8, 1940.

4. In holding that petitioner Jesse L. Lasky received royalties under his contracts of May 15, 1940, with Warner Bros.

5. In holding that petitioner's right to a share in the proceeds of the motion picture "Sergeant York" was due to his contribution as a producer.

6. In holding that the evidence failed to show that a bona fide dispute existed in 1942 between petitioner Jesse L. Lasky and Warner Bros.

7. In holding that the sale by petitioner Jesse L. Lasky, on December 4, 1942, to United Artists Corporation was not a bona fide sale to a third party with no understanding that United Artists Corporation would resell to Warner Bros.

8. In holding that United Artists Corporation was a mere intermediary in the transaction whereby petitioner Jesse L. Lasky sold his rights under the contracts of May 15, 1940, with Warner Bros. to United Artists Corporation.

9. In holding that there was no business purpose behind petitioner's sale to United Artists Corporation on December 4, 1942.

10. In determining that petitioner Jesse L. Lasky pr ferred to have his share of the preceeds from the pictu "Sergeant York" accrue and accumulate in the hands Warner Bros.

11. In holding on rehearing that: "It is concluded th Lasky sold his accrued earnings in the picture Sergea York, which amounted to $822,857.56, to United Artists a 'discount' of over $17,000, and that United Artists co lected from Warner Brothers, Lasky's share of the accru earnings to the extent of $820,000, thereby bringing abo Warner Brothers' acquisition of the 25 per cent intere of Lasky for no more than the accrued earnings of the per cent interest."

12. In holding and deciding after the rehearing and r consideration that the proceeds from the sale by petition Jesse L. Lasky of his rights under contracts of May 1 1940, with Warner Bros. to United Artists Corporatio for $805,000, were taxable as ordinary income instead at capital gains rates.

13. In holding and deciding that petitioner Bessie Lasl owed a deficiency in income tax for the year 1943 in t amount of $224,722.55.

14. In holding and deciding that petitioner Jesse Lasky owed a deficiency in income tax for the year 19 in the amount of $224,515.14.

15. In that its opinion and decisions are not supporte by the evidence.

16. In that its opinion and decisions are contrary to la

ARGUMENT

The gain from the sale of petitioner's contractual rights with Warner Bros. to United Artists Corporation on December 4, 1942, is taxable as capital gain from the sale of a capital asset.

The question here presented for decision is whether the gain realized by petitioner upon the sale of certin contractual rights to United Artists Corporation on December 4, 1942, is taxable as ordinary income or as capital gain. The Tax Court by disregarding uncontradicted and unimpeached testimony of reputable witnesses and by drawing unwarranted inferences and conclusions in the teeth of positive evidence to the contrary decided that the transaction was a sham and that the gain was taxable as ordinary income. In addition the Tax Court misinterpreted and misapplied the law to the facts. To resolve the question here involved, the Tax Court considered first the transaction whereby petitioner acquired certain rights by contract from Sgt. York which were sold to Warner Bros. and, secondly, the transaction of December 4, 1942, whereby the petitioner sold to United Artists Corporation the contractual rights he had with Warner Bros. The important thing to determine is what was purchased and what was sold in each transaction.

The contract of March 23, 1940, between petitioner and Sgt. York conveyed to Lasky the exclusive motion picture, radio, television, and dramatic rights to the life story of York. This contract was a valuable property right. Petitioner by contract dated May 15, 1940, conveyed all of his rights, title, and interest under the contract of March 23, 1940, with York, to Warner Bros. It is important to determine exactly what Lasky sold to Warner Bros. As can clearly be seen from the contract, petitioner sold all of his rights, title and interest under the contract with York, to Warner Bros. (R. 38-40) It was not merely a licensing or rental agreement. Petitioner sold all of his "bundle of

rights" under the contract. The contract of May 15, 194 between petitioner and Warner Bros. Pictures, Inc., speci ally provided: (R. 39)

> "In consideration of the covenants of the Purchas herein contained and of the payment of the sums the times and in the manner hereinafter provided, t Seller does hereby grant and assign to the Purchas all the right, title and interest of the Seller in, to under the said agreement of March 23, 1940, (Exhib 'A'), together with any and all rights, licenses and/ privileges acquired by him therein and thereunder."

In consideration for all of petitioner's rights, title and i terest under the contract of March 23, 1940, Warner Bro agreed to pay petitioner $40,000 plus a certain percenta of the gross film rentals or sales realized from the distrib tion of the photoplay.[1]

The foregoing facts clearly distinguish the transactio in the instant case from those in *Sabatini* v. *Commissione* (CA-2, 1938) 98 F. 2d 753, 21 A.F.T.R. 800; *Goldsmith Commissioner,* (CA-2, 1944) 143 F. 2d 466, 32 A.F.T.R. 100 cert. denied 323 U.S. 774; *Rohmer* v. *Commissioner,* (CA- 1946) 153 F 2d 61, 34 A.F.T.R. 826, cert. denied 328 U.S 862; *Commissioner* v. *Wodehouse,* (1949) 337 U.S. 369, 9 L.Ed. 1419. In each of these cases, authors who held cop rights conveyed or licensed to others certain rights les than all of the author's "bundle of rights" under his cop right. In other words, they did not sell their entire interes but merely licensed their work for a particular object period. There was no transfer of title necessary to a con

---

[1] The mere fact that part of the payment on the sale by petitioner to Warn Bros. was a percentage of the gross receipts does not prevent capital gai treatment. The method of payment, whether it be a flat sum, fixed instal ments or payment of a percentage of the gross receipts, sales or profits, do not change the fact that a sale occurred. *Commissioner* v. *Celanese Cor* (USCADC, 1944) 140 F. 2d 339, 32 A.F.T.R. 42; *Commissioner* v. *Hopkins* (CA-2, 1942) 126 F. 2d 406, 28 A.F.T.R. 1349; cf. *Raymond M. Hesse* ¶47,301 P-H T.C. Memo.

pleted sale. Here, Lasky conveyed all of his rights under the contract of March 23, 1940, with Sgt. York to Warner Bros. There was a completed sale. Petitioner reported the income under the contracts with Warner Bros. during the year 1941 as ordinary income because at the time of the sale to Warner Bros., he had not held the property rights in the contract with Sgt. York for the requisite holding period so as to be entitled to report the proceeds of the sale as long-term capital gain. Respondent, in his brief in the Tax Court, admitted that the sale by petitioner of his rights under the contract of March 23, 1940, to Warner Bros. was the sale of a capital asset, but argued it was not a long-term capital gain because petitioner held the rights less than one month. Had petitioner held his rights the necessary holding period, the gain would have been a long-term capital gain under the cases of *Herwig et al.* v. *United States,* (1952) 122 Ct. Cl. 493, 105 F. Supp. 384, *Fred MacMurray,* (1953) 21 T. C. 15, and *Anatole Litvak,* (1954) 23 T. C. 441. Accordingly, it is the petitioner's position that the moneys received by Lasky during the year 1941 under the contracts of May 15, 1940, with Warner Bros. were proceeds from the sale of Lasky's property rights under the contract of March 23, 1940, with York, and not royalties, as determined by the Tax Court.

After the picture "Sergeant York" was released in July 1941, a dispute and dissatisfaction existed between petitioner and Warner Bros. Petitioner was dissatisfied with the way Warner Bros. was distributing the picture. He was also dissatisfied with the receipts that were tendered him from the distribution of the picture. He consulted his attorney and accountant regarding what action he should take. They advised him to have an audit made of the distribution of the picture by Warner Bros. His attorney also advised him not to accept the proceeds from the distribution of the picture "Sergeant York" tendered him by Warner Bros. as it might preclude him from demanding an adjustment in the account if it were found he was entitled to one upon an accounting. By the very re-

turn of the checks tendered, Warner Bros. was placed on notice of petitioner's dissatisfaction. Petitioner's attorney had a conference with executives of Warner Bros. about criticisms which he had heard about Warner Bros.' handling of the York picture. (R.281) Warner Bros. was aware that petitioner was dissatisfied with the distribution and his receipts from the distribution of the picture "Sergeant York". Officials of Warner Bros. expressed to third parties that they were cognizant of the fact that petitioner was dissatisfied.[2] (R.361-362) Likewise, Warner Bros. was dissatisfied with the arrangements they had made under the contracts with Lasky. By letter of November 24, 1941, Warner Bros. requested petitioner to increase the base before he would begin to participate in the percentage of gross rentals from $1,600,000 to $2,200,000. They requested him to participate in an advertising campaign although he was not required to do so under his contract. They withheld moneys due petitioner because of a claim of plagiarism although they were not justified in doing so under the contracts. They proposed to withhold $200,000 of foreign receipts due petitioner although they were not entitled to do so under the contracts.

During all this period of time, petitioner was in the employ of Warner Bros. as a producer. Prior to 1940 petitioner had been employed from time to time as a producer by a number of different companies. He was interested in avoiding any additional unpleasantness or controversy with Warner Bros. in order that he might continue in their employ as a producer for the balance of his natural life. For this reason, petitioner was reluctant to have an audit made because he felt that an audit would show discrepancies and that he was entitled to additional

[2] In the contract between United Artists Corporation and Warner Bros. Pictures, Inc., of December 22, 1942 (R. 439-444) Warner Bros. required United Artists to release it from all claims that Lasky might have against Warner Bros. relating to the motion picture "Sergeant York." This showed that Warner Bros. was familiar with Lasky's claims and his dissatisfaction.

moneys. Petitioner realized that by having an audit made, his position as an employee of Warner Bros. would become untenable. Petitioner felt that if he could dispose of his rights under the contracts of May 15, 1940, he would be able to continue in the employ of Warner Bros. without any further trouble or dispute. In other words, if he no longer held the rights under the contracts he would not be concerned with the distribution or the receipts from the distribution of the picture. Likewise, Warner Bros. would not be able to make any further demands on him for concessions under the contracts. Accordingly, the business purpose to Lasky behind the sale of his rights in the contract with Warner Bros. Pictures, Inc., of May 15, 1940, to United Artists Corporation on December 4, 1942, was to put an end to the dispute and dissatisfaction which existed between him and his employer in order that he might continue thereafter in the employ of Warner Bros. as a producer. This evidence shows that the Tax Court was clearly wrong in concluding that there was no showing of any business purpose to Lasky in his contract with United Artists on December 4, 1942. (R-90).

The Tax Court was likewise in error in concluding that United Artists was a mere intermediary in the proceedings. The evidence shows that the sale by petitioner on December 4, 1942, to United Artists was a bona fide sale to a third party without any knowledge or understanding on petitioner's part whatsoever that United Artists Corporation would resell the rights they acquired to Warner Bros. The evidence shows that petitioner's attorney offered to sell petitioner's rights under the contracts with Warner Bros. to Adolph Zukor and to United Artists Corporation. He sold the rights to United Artists Corporation because they agreed to pay him the most money for the rights. The testimony of the President of United Artists Corporation and the General Sales Manager shows that their only purpose in acquiring the rights of petitioner under the con-

tracts of May 15, 1940, with Warner Bros., was a busines purpose. They were only interested in buying the right if United Artists Corporation could make a profit out o the transaction. The General Sales Manager of Unite Artists Corporation wanted to acquire the rights and hol them so that United Artists would receive the proceed from the distribution of the photoplay over a period o time. On the other hand, the President of United Artist was interested in making a quick profit out of the trans action by reselling the rights. His reason for doing s was that he wanted to make a quick profit in the year 194 and also because United Artists did not have the right t distribute the picture.

The Tax Court, in its order and decision on rehearing stated:

> "* * * The Court concludes that the transaction o United Artists with Lasky, and the transaction o United Artists with Warner Bros. shortly thereafte must be considered together and that although Lask may not have been aware of all the discussions an considerations of his chief agent, his attorney, neve theless, his agent's actions must be imputed to Lasky * * *" (R. 140-141)

This conclusion of the Tax Court completely disregard the uncontradicted evidence before it and is made in th teeth of the only evidence in the record. Mr. Loyd Wrigh the attorney for Lasky, who negotiated the sale, testifie that he did not know about the sale from United Artist to Warner Bros. on December 22, 1942, until after it wa an accomplished fact. This testimony appears in the rec ord on page 283, as follows:

> "Q. (By Mr. McLane): I show you a contract o sale, marked Exhibit AA, Mr. Wright, and ask whethe or not your firm represented United Artists in th transfer of the rights under that contract to Warne Brothers on December 22, 1942?

"A. No. We had nothing whatever to do with it.

"Q. You mean United Artists had other legal advice other than yourself?

"A. That is handled in the New York office. I never had seen it. I had no knowledge of it until after it was accomplished."

Likewise, Mr. Miller and Mr. Lasky also testified that they had no knowledge that United Artists contemplated or intended to resell Mr. Lasky's rights to Warner Bros. (R. 324, 351). In addition, Mr. Raftery, President and Chief Counsel for United Artists Corporation, testified that he never saw Mr. Lasky during the negotiations leading to the contract of December 4, 1942, and that he had no understanding of any kind with Mr. Wright that he would transfer or resell the rights United Artists acquired from Mr. Lasky to Warner Bros. (R. 360-361)

Viewed in the light of this evidence, it is clear that the transaction of December 4, 1942, whereby petitioner sold his rights under the contract to United Artists Corporation, was a bona fide transaction surrounded by good business reasons on behalf of all parties. It may be that the petitioner from a financial standpoint made a poor "deal". However, it was a transaction that was entered into honestly and as the result of advice from his advisors. Under these circumstances the Court will not be concerned with the quality of the consideration petitioner gave or received but only with the taxability of that which he received. The payment of the $805,000 was made by United Artists Corporation to acquire all of his rights and property of every kind whatsoever under his contracts of May 15, 1940, with Warner Bros. The contractual rights sold to United Artists Corporation were entirely different from those sold to Warner Bros. on May 15, 1940. Warner Bros. was sold petitioner's rights under contract with York of March 23, 1940. The property rights under the contracts of May 15, 1940, had been held by petitioner for more than six months

and since he transferred all of his right, title and intere under the contracts to United Artists Corporation, it wa a completed sale and the proceeds are entitled to be treate as capital gain.

Petitioner is unable to find any appellate court cases tha are directly in point with the issue here presented. Hov ever, in the recent case of *Pat O'Brien et al.*, 25 T. C. N 48 (decided November 30, 1955) the Tax Court passed upc the identical issue here involved and there held that th sale of a percentage of the net profits of a picture was th sale of a capital asset. In the *O'Brien* case, petitioner Ph L. Ryan on August 29, 1945, sold to RKO Pictures, Inc his option on the story from which the motion pictur "Fighting Father Dunn" was made. He received a 10 pe cent interest in the net profits of the picture and a contra to produce the picture at a salary of $30,000. In Jul 1947, he sold one-half of his 10 percent interest in the ne profits to a director of the film and reported the prof thereon as long-term capital gain. The Tax Court ther said:

> "The fifth and final issue is whether the respond ent erred in determining that the profit realized b Phil L. Ryan from the sale of one-half of his 10 pe cent interest in "Fighting Father Dunn" constitute ordinary income rather than capital gain. We thin the respondent's determination was erroneous.
>
> "The attorney for RKO, who testified at the hea ing, made it very clear that RKO purchased the stor by giving Ryan a 10 per cent interest in the net profit of the picture and by employing him as the produce of the picture at a salary of $30,000. RKO paid $50 000 to the author of the story and gave him a 5 pe cent interest in the net profits of the film.
>
> "The respondent argued on brief that the story, o the option thereon, could not be a capital asset i Ryan's hands since his previous activity in purcha ing and selling stories indicated that he was in th business of doing so. That argument misses the poin altogether. What Ryan sold in 1947 was not the stor

but an entirely different asset, namely, one-half of his 10 per cent interest in the net profits of the motion picture. The record as a whole indicates that Ryan was not in the business of buying and selling interests in motion pictures. Hence, his 10 per cent interest in "Fighting Father Dunn" was a capital asset which he had held for more than six months prior to the time when he sold one-half of it. The profit on such sale was a capital gain."

In Pacific Finance Corporation of California ¶53,129 P-H Memo T.C., the petitioner purchased for $450,000 the first $550,000 of gross receipts of the photoplay "Rebecca" from the producer David O. Selznick and associates. After receiving approximately $375,000 the petitioner sold its interest in the photoplay to Vanguard Films, Inc., for about $175,000 thus realizing a gain of $100,000. Vanguard Films, Inc., was a company owned by Selznick. The Tax Court held that the gain of $100,000 on the sale was capital gain.

In the instant case, what Lasky sold to United Artists on December 4, 1942, was his interest in the motion picture "Sergeant York." Petitioner had held these property rights from May 15, 1940. Accordingly, petitioner's interest in the motion picture constituted a capital asset since it was not (a) stock in trade of the taxpayer or other inventory property; (b) property held primarily for sale to customers in the ordinary course of his trade or business; (c) depreciable property used in trade or business; or (d) short term government obligations. The decision in the case at bar is out of step with the *O'Brien* and *Pacific Finance Corporation of California* cases and the statute taxing the gain on the sale of a capital asset.

The opinion of the Tax Court in this case wholly disregards the proven facts. It states conclusions not based on the evidence. The opinion states: "Lasky, for reasons which are rather vague in the record before us, elected not to take the shares which accrued periodically and were

tendered to him until it became clear that the credits alo
would suffice because Lasky preferred having the accrua
of his shares accumulate in the hands of Warner Bros
(R. 88-89) There was positive evidence in the record wh
Lasky did not accept the moneys tendered to him by Wa
ner Bros. Loyd Wright, his attorney, advised him n
to accept the moneys that were tendered because in h
opinion the legend on the vouchers would preclude Lasl
from demanding an adjustment if it were found that
was entitled to additional moneys. (R. 72, 241-242, 27
316, 351-352) Accordingly there was nothing vague abo
petitioner's rejection of the tender—he acted on the advi
of counsel. There is no evidence in the record that pe
tioner "preferred" having his shares accumulate in t
hands of Warner Bros.

The opinion states: "It is difficult to know, or find as
fact, that a bona fide dispute existed in 1942 between Lasl
and Warner Bros." (R. 89) This is an astonishing concl
sion in the light of all the evidence about the dissatisfacti
and controversy that existed between Lasky and Warn
Bros. The details and causes of the dispute will not
reiterated here. However, the correspondence betwe
the parties, their expressions to third parties, and the fa
that Lasky consulted his attorney and accountant abo
the controversy and the fact that the attorney took t
matters up with Warner Bros. showed beyond questi
that disputes and dissatisfaction existed between the pa
ties. This evidence cannot be disregarded.

The opinion states: "For example, there is no testimo
of any executive of Warner Bros. about any dispute
about the receipt by Warner Bros. of allegations of Lasky
(R. 89) Lasky had a dispute with Warner Bros. Nat
rally its executives are not going to testify on his beha
However, this does not justify the Tax Court in disregar
ing all the other testimony and other evidence in the re
ord on this point. Petitioner's attorney had a conferen

with officers of Warner Bros. about the treatment of the picture. (R. 281) The very fact that the checks were returned placed Warner Bros. on notice of petitioner's dissatisfaction. Officers of Warner Bros. expressed to third parties that they were cognizant of the fact that petitioner was dissatisfied. (R. 303-304, 360-362) In addition, Warner Bros. required United Artists to release it from all claims that Lasky might have against Warner Bros. relating to the picture "Sergeant York." (R. 439-444)

The Tax Court in substance concludes that the sale by Lasky to United Artists was a sham and accomplished no more than an ending of the Warner Bros.-Lasky agreement, with United Artists as a mere intermediary. The business reasons behind each transaction shows this conclusion to be wrong. The uncontradicted testimony of unimpeached witnesses to the contrary cannot be disregarded.

CONCLUSION

A fair review of the evidence in this case leads to the inescapable conclusion that the sale by petitioner of his property rights to United Artists Corporation, on December 4, 1942, was a sale of a capital asset within the provisions of Section 117 of the Internal Revenue Code of 1939. The decisions of the Tax Court should be reversed.

Respectfully submitted,

Robert Ash
Carl F. Bauersfeld
1921 Eye Street, N. W.
Washington 6, D. C.
Attorneys for Petitioners

February 23, 1956